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FREE TRADE UNDER ATTACK: WHAT AMERICA CAN DO

By Murray L. Weidenbaum

Editor's Preview: Free trade is a consumer issue. It lowers inflationary pressures by increasing the supply of goods and services competing for every dollar. Free trade is a jobs issue. It yields more growth and higher levels of employment. Free trade is a freedom issue. It helps minimize government influence over the decisions of private individuals and firms.

Yet despite these benefits, warns Murray Weidenbaum, former chief economic adviser to President Reagan, the open trading system of the free world is under attack. Tight-knit special interests are manipulating the political system for greater protectionism, while the more diffused citizen interest suffers. This despite the fact that tariff reductions yield \$50 to \$100 in economic benefits for every \$1 of job dislocation they cause.

The United States, whose own federal system was the first common market, does not come to the trade question with clean hands today. Weidenbaum cites serious government restrictions on both imports and exports, for which our own people and world prosperity are ultimately penalized.

He proposes a four-part strategy for reasserting American leadership in free trade. More is required, the von Mises memorial lecturer observes wryly, than a government-business charade that denounces foreign tariffs on Monday and returns to raise our own tariffs on Wednesday.

For a conservative economist, it is a great pleasure to present the Ludwig von Mises Lecture. I will try to do him appropriate honor by dealing with the current and pressing problem of maintaining free markets at a time of rising protectionist pressures.

The sad fact is that the open trading system of the free world is under attack at home and abroad. It is especially important, therefore, that we reinforce our intellectual defense of the free market, especially its international dimensions.

The case for free trade is rooted in a basic economic law: the principle of comparative advantage, which holds that total economic welfare will be enhanced if each nation specializes in the production of items that it can produce, in relative terms, most efficiently. This, of course, is an important case of Adam Smith's more general point concerning the advantages of the specialization of labor.

Through most of the twentieth century, the United States has played a strong leadership role in developing the world trading system. During the 1930s, however, the United States and many other countries followed "beggar-thy-neighbor" trade policies which contributed substantially to the worldwide depression.

After World War II, this country embarked on a program of reciprocal trade agreements. Initially arranged bilaterally, they evolved into the effective multilateral trading system of the postwar years. This approach broke

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down many of the historical barriers to world trade. An especially fine example occurred in the 1960s. The acceleration in world trade and economic growth in that decade followed a sharp and mutual reduction in tariff barriers which contributed to lower prices for consumers. We continue today to reap benefits from the policies initiated in those years.

U.S. Began as a Trader

We can turn to our own economic history for earlier examples of the benefits of an open economy. This country began as a trading nation. If the concept of "Gross National Product" had existed in the eighteenth and nineteenth centuries, people would have pointed to the United States as one of the more open economies in the world, as measured by the share of GNP involved in foreign trade. I say that even though tariff debates were common throughout the nineteenth century.

Around the turn of the century the dynamics of the American economy shifted. Exports and imports became smaller shares of GNP and remained rather stable. U.S. investment abroad increased, gradually transforming us from an international debtor into a world creditor. Increasingly, we became a self-sufficient economy. Only in the last 20 years has the international sector once again begun to increase its relative importance in our economy.

Foreign trade is now an important element in U.S. business and employment. Exports and imports of goods and services each now represent over 12 percent of our Gross National Product. Twenty years ago, exports were less than 6 percent of GNP; imports, less than 5 percent.

About Murray Weidenbaum

Murray Weidenbaum is the Mallinckrodt Distinguished Professor of Economics at Washington University in St. Louis. He also directs the university's Center for the Study of American Business, where he continues his contributions as one of this country's foremost authorities on the effects of government regulation of private enterprise.

For the first 18 months of the Reagan Administration, Dr. Weidenbaum served the President as Chairman of the Council of Economic Advisers. Earlier he had been Assistant Secretary of the Treasury for Economic Policy (1969-71), a fiscal economist in the U.S. Bureau of the Budget, and a corporate economist at the Boeing Company.

Murray Weidenbaum is a 1948 graduate of the City College of New York. He received his M.A. from Columbia in 1949 and his Ph.D. from Princeton in 1958.

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Much of this shift has occurred in the past decade, when imports and exports as a share of GNP have doubled and a positive export balance has been maintained.

In passing, we should note that there is a close, but not generally appreciated, connection between imports and exports. A strong trade position requires both a high volume of imports and a high volume of exports. In fact, the only way, in the long run, to increase a country's exports is to increase its imports. U.S. exporters need to find foreign buyers with the dollars necessary to buy their goods and services. In general, these dollars are obtained when Americans import and pay for foreign goods and services.

In the short run, it is true that we can and do lend foreigners the dollars with which to buy our exports. When such loans are made at market rates of interest, trade is properly advanced. But when government-subsidized credit is provided, such funds are denied to other, more productive uses in the domestic economy.

Two-Way Street

Imports put dollars in the hands of foreigners—dollars which can then be used to buy our exports. It follows that restrictions in imports will result in fewer dollars in the hands of those in other countries who might want to buy our wheat, aircraft, chemicals or machinery—unless, of course, we make up the difference by loans or transfer payments to foreigners.

In some cases, the connection between imports and exports is even more direct. Import restraints can reduce employment and profits in our more productive export industries, in many cases in the same region of the country. For example, in the non-rubber footwear industry, U.S. exports of hides to foreign shoe producers suffered as a result of our restraints on the import of foreign shoes.

Let us generalize from historical experience. The benefits of free trade are numerous:

1. Open trade contributes to lowering inflationary pressures by increasing the supply of goods and services competing for the consumer's dollar. Thus, the question of free trade is basically a consumer issue, and an extremely important one.
2. Open trade minimizes the role of government in influencing private-sector decisions. This allows individuals and business firms to respond to the needs and pressures of the international marketplace. Viewed in this light, free trade is key to promoting economic freedom and the private-enterprise system.
3. Open trade improves the efficiency with which our own resources are allocated. Thus, we can see that free trade yields more growth, higher levels of employment, and an improved living standard here at home.

Aside from the direct and measurable aspects, trade stimulates competition, stirs creative energies, rewards individual initiative, and increases national productivity.

Among nations, it speeds the exchange of new ideas and advanced technology. In the long run, international trade means the creation of new jobs and the reduction of inflation.

In this time of great interest in benefit/cost analysis, we may inquire as to what are the costs of free trade as well as the benefits. The obvious costs are those borne by the workers who become unemployed as a result of imports—assuming that imports are the cause.

Forced Transfers, Made in Washington

What is less apparent, however, is that any form of trade restraint to help a specific industry affected by imports really is an internal transfer of income and wealth to that industry from U.S. consumers. That transfer takes the form of shifts of income and wealth away from American workers and owners of our export industries, who bear the brunt of retaliatory trade restrictions in the form of lower wages and lower profits.

Moreover, many of the benefits of protectionist measures, even to the group advocating them, turn out to be very temporary. For example, quotas on shoe imports resulted in an upgrading in the *quality* of imports. Thus, American producers found themselves threatened in that part of the market in which, prior to the protectionist action, they firmly dominated. The same process is taking place in the current case of "voluntary" restraints of Japanese auto imports.

One of the great difficulties in public policy discussions involving protectionist measures is that the beneficiaries are usually few in number. Yet each has a large individual stake in the outcome. Moreover, those who benefit from protectionism have little concern about the likelihood of retaliation by foreign governments on other American industries. Thus, the incentive is strong for vigorous and concentrated political activity designed to erect special-interest trade barriers.

In addition, pleas for protectionism reflect the ability of relatively small but influential groups to convince legislatures to adopt policies that benefit them, albeit at the expense of citizens at large. The balance of power is extremely uneven, given the limited knowledge that consumers currently have about these matters.

Those who benefit from exports and from the greater supply of goods and services are generally not even aware of the process by which they benefit. Although the benefits of open trade may far exceed the costs, those benefits—such as lower prices to consumers—are widely diffused among 50 states and 225 million residents. Any single consumer's stake in the outcome is quite small. The individual consumer almost surely is not aware of why the price of a given item is going down—or not rising. Consequently, resistance at the grass-roots level to protectionist measures often is considerably less than pressures for their adoption.

Nevertheless, the consumer savings from freer trade exceed any sensible adjustment programs instituted for those who are initially hurt by the change.

Scholarly studies typically show that the total benefits of freer trade far exceed the costs. These gains from trade include savings to consumers, gains from moving resources out of inefficient sectors, stimulus to investment, and increased economies of scale. One study concluded that the benefits of tariff reductions are approximately 80 times as large as the costs of labor adjustments. Those costs are primarily the unemployment resulting from increased imports.

High ratios of economic benefits of trade liberalization to labor adjustment costs have also been estimated for other nations, ranging from 49 to 1 in Japan to 96 to 1 in the European Economic Community. Both aggregate and specific comparisons show that the benefits of protectionist measures are far less than the total costs imposed on society.

Resenting Their Barriers, Excusing Ours

Despite the lip service that is paid so often to the virtues of free trade, there is great danger that the United States may be taking the lead in the current rush toward protectionism. Public policy debates are increasingly dominated by one-sided, self-serving views of international trade. Everyone wants open markets and free trade overseas. We all know how urgent it is to eliminate *their* barriers to our exports. But *our* barriers in the United States to their exports do not generate much interest over here.

The problem can be explained with a simple example—Country A and Country B. Country B has a large export surplus with Country A. Country A has great difficulty getting its exports into Country B. Sounds familiar? Of course, Country B (large trade surplus) is Japan and Country A (large trade deficit) is the United States.

But that is not the end of the story. When we take another look, we find that Country B (large trade surplus) is also the United States and Country A (large trade deficit), Western Europe. After all, we have enjoyed a trade surplus with the Common Market over the last decade, about as large as Japan's surplus with us. It would help to clear the air in international trade discussions if the United States were to acknowledge that we do not have clean hands.

Let us remind ourselves of our many departures from free trade. For example, "Buy American" statutes give preference to domestic producers in government procurement. As much as a 50 percent differential is paid for military goods produced at home. In addition, the Surface Transportation Assistance Act requires that, for most purchases over $500,000, American materials and products be used for that mass transit subsidy program. Also, American flag vessels must be used to transport at

least 50 percent of the gross tonnage of all commodities financed with U.S. foreign aid funds.

And then there are the Buy American laws of the various states. New York requires state agencies to buy American steel. New Jersey requires that all state cars must be domestically produced. In addition, numerous states and municipal authorities require use of American materials in utilities, whether privately owned or publicly owned.

Block That Mushroom

Let us not forget the Jones Act. That piece of special-interest legislation prohibits foreign ships from engaging in commerce between American ports. This law, of course, effectively bars all competition in U.S. domestic marine transport. The perverse effects of such cabotage laws are greater than might be expected. For example, at times Canadian lumber transported in Japanese flag vessels has undersold domestic timber from Oregon in the lucrative Southern California markets. In such cases, both the American merchant marine and the American timber industry suffer damage.

Many other statutes limit imports of products such as sugar, beef, dairy produce, and mandarin oranges. Under the Meat Import Act, the President has authority to impose import quotas on beef if imports reach a certain trigger level. In practice, the U.S. has "encouraged" foreign exporters to restrain their sales "voluntarily" to avoid the imposition of formal quotas.

Although our average tariff rates are low, high tariffs are levied on selective items. Tariffs on textiles average 20 percent. Duties on fruit juices are over 27 percent, and the rate on ceramic products is over 14 percent. All this is in addition to numerous nontariff barriers, often of a regulatory nature and imposed by federal, state, county, and municipal governments.

Despite this nation's overall free-trade posture, protection against imports into the United States now covers such basic industries as automobiles, steel, and textiles. Pleas for further trade restrictions extend to such esoteric sectors as mushrooms, ceramic tableware, and mechanics' shop towels. It is not a question of merely accepting the existing array of protection. The challenge is to deal with the rising pressures for further restriction of world trade.

Protectionist measures are a two-edged sword. They may reduce imports from abroad. The United States was "successful" in getting the Common Market to restrict its exports of steel to this country. But let us examine the results. First of all, the domestic automobile industry, a major purchaser of steel, bears the burden of higher costs, which in turn make it less competitive. In addition, lower imports mean fewer dollars abroad to buy American exports. All this generates pressures for more protection.

Furthermore, protection often generates retaliatory measures, which hit the unprotected sectors of the economy. For example, in January 1983, the U.S. government imposed import quotas on textiles and apparel from China. It is interesting to note that this action followed the breakdown of negotiations for the extension of a "voluntary" quota that expired at the end of 1982. The Chinese government retaliated by cancelling new contracts for the importation of U.S. cotton, synthetic fiber, and soybeans. China's retaliation to our trade restrictions hit a very different sector of the economy and had a much broader regional effect than the beneficiaries of the protectionist action.

How We Impede Exports

Moreover, we must acknowledge that in the United States many laws and regulations limit our exports. In many ways—and often without considering the effects—we have enacted laws and promulgated regulations that prohibit U.S. exports or make it more difficult for American companies to export.

For example, the Trans-Alaskan Pipeline Authorization Act prohibits the export of oil from North Slope fields.

A provision added to an appropriations act for the Interior Department bans timber exports from federal lands west of the 100th meridian.

The Export Administration Act provides for controls on exports of goods and technology to protect national security. That sounds fine. But, in practice, the law mandates controls over a great variety of products, including domestically produced crude oil, refined petroleum products, unprocessed red cedar and, my favorite, horses exported by sea.

In 1980 the act was employed to embargo grain exports to the Soviet Union. It was invoked again in 1982 to carry out the ban against U.S. firms participating in the construction of the natural-gas pipeline between the U.S.S.R. and Western Europe.

Studies of how export controls actually work conclude that the more sensitive applications for approval under the Export Administration Act get tied up in a bureaucratic morass. There is a good deal of evidence that the licensing system has been a powerful disincentive to exporting.

Exports controls do more than limit U.S. international trade for the time they are imposed. Such restrictions call into question the long-term reliability of the United States as a future supplier of products to other countries. Those nations are likely to develop alternative sources.

A clear example is soybeans—hardly a product that could be considered a strategic item. The main effect of the U.S. embargo of soybean exports in 1974 was to induce Japan to turn to other producing countries, particularly Brazil. Japan proceeded to invest huge amounts in that country to develop alternatives to U.S. produc-

tion, thus effectively and permanently reducing our share of the world soybean market.

The United States also conducts a great variety of domestic regulatory activities that impose costly burdens on American manufacturers. In many cases, foreign producers are not subject to similar burdens. In addition, the federal government has imposed special burdens on companies involved in foreign trade. The Foreign Corrupt Practices Act requires strict recordkeeping standards to monitor the anti-bribery sections of the statute. It is difficult to discuss that law without being criticized for callousness on ethical matters. However, the sad fact is that this international trade statute has established a regulatory regime that displays the same cavalier attitude toward the burdens it imposes on American business as do so many domestic-oriented regulations.

A former Chairman of the Securities and Exchange Commission, the agency administering the act, has stated, "The anxieties created by the Foreign Corrupt Practices Act—among men and women of utmost good faith—have been, in my experience, without equal." The language of the act is so sweeping and ambiguous that American firms turn down foreign business when they merely suspect that they could be charged with actions that technically might be classified as bribery, although in practice these payments may be closer to paying protection money to the Mafia. The General Accounting Office found, in a survey of 250 American companies, that 30 percent of the respondents engaged in foreign trade had lost business as a result of the Foreign Corrupt Practices Act.

In addition to the effects of trade policies themselves, the strong foreign exchange value of the dollar makes it difficult for American companies to compete in world markets. Many factors influence the strength of a nation's currency. But our extraordinarily high real interest rates are very important. In turn, the large budget deficits are a key influence on those high rates—and we cannot blame the deficits on "foreign devils." They have a made-in-America label.

Foreign Threats to International Trade

By no means is the United States the only nation with trade barriers. Every nation has them. The European Community levies duties on wheat, barley, oats, sorghum, rye and rice. Italy bans foreign-produced television commercials. Japan finds all sorts of reasons for keeping out baseball bats.

Japan commands our attention in this regard and some special consideration of this important trading nation is appropriate. Viewed from a broad, historical perspective, Japan, of all the major developed nations, has most recently made the transition from a developing country to a mature, industrialized economy. However, it has only begun to change its policies and customs to reflect that fundamental shift. Yet, looking at the decade of the 1980s, it is clear that Japan now has a key stake in the health of the world trading system. It has benefitted most substantially from the greater openness of the economies of the rest of the world. Without that liberal environment, I doubt that its export-led growth would have occurred. Surely, steps to open its markets more widely to foreign trade and investment are long overdue.

The sooner that Japan succeeds in adjusting its trade posture to current economic realities worldwide, the sooner will its trade relations with more open economies move to a more amicable basis. Under the circumstances, I am pleased to note the recent steps that the Government of Japan has taken to reduce its tariffs and to soften administrative barriers to imports. As Foreign Minister Abe (the former head of MITI) has said, "I myself do not feel that the requests from America regarding market liberalization are pressures. These are things that Japan should be doing anyway." No doubt, from the viewpoint of Japan, the recent moves to liberalize trade came very rapidly. To outside observers, however, it is more a matter of making up for a very late start.

Threats to free trade are multiplying, with a growing array of industrial sectors obtaining "protection." The concerns of these producers and the public will be better served by responding to the far underlying problems that generate pressures for protectionism. This leads me to the policy implications of these remarks.

Four Positive Strategies

As I see it, the United States should simultaneously pursue four positive and mutually supportive approaches in combatting protectionism and promoting free trade. First and most fundamental is carrying out domestic economic policies that expand production and incomes while holding down inflation. This, of course, is a plea for tax cuts, reduction in government spending, and regulatory relief. A healthy economy nips the protectionist bud at its source.

The second approach to promoting free trade is to achieve greater stability and balance in macroeconomic policies. The shift in 1981 to tight monetary policy and expansive fiscal policy in the United States contributed substantially to high interest rates and a rise in the value of the dollar coupled with recession. If we are not careful, we will now see an easy-money policy—coupled with outsized budget deficits—lead to another inflationary spiral. That would further reduce the competitiveness of U.S. products in world markets.

The third approach to promoting free trade is to limit any governmental "trade adjustment assistance"—which seems to be a politically necessary part of any comprehensive trade policy—to temporary aid in shifting labor and capital from industries hard hit by imports to more competitive activities. All too often, the government aid merely maintains an inefficient and uncompetitive industrial structure. That, in turn, adversely affects our competi-

tiveness in world markets and, predictably, generates further pressure for additional protectionist measures. The result is to lower domestic employment, which, in turn, generates additional pressures for government interference. That is an example of a more general principle: government intervention begets more government intervention.

In a healthy and dynamic economy we must expect that some industries and regions will grow more rapidly than others and that some sectors will experience difficulty in maintaining their position and may even decline. We must rely primarily on market forces, and not on government bailouts, to make the appropriate adjustments.

In a related aspect, the developing nations need adequate access to the markets of the more developed countries if they are going to be able to service the massive indebtedness that they have incurred. However painful, the developed nations must adjust their economic structures to this reality.

The fourth approach to promoting free trade is to acknowledge the positive role of multinational corporations in the world economy. Multinationals adapt to change more readily and are less likely to plead for protection than other companies. They also are the private-sector alternative to foreign aid and other types of government intervention. This, of course, explains why so-called transnational enterprises are not universally popular, especially among the bureaucracies of international governmental organizations.

Ending the Monday—Wednesday Charade

The serious question facing us is how to encourage our trading partners to open their markets without using mechanisms that harm the international trading system or start a spiral of retaliation. The current interest in what is now called "reciprocity" raises such dangers. Yet, until markets are open more fully, these pressures will continue.

But the current economic problems that face most countries will not be solved by responding to the parochial concerns of steel producers, citrus growers, and automobile makers. Nor should international economic relations be dominated by short-term protectionist pressures from the producers of edible seaweeds, casein, and manhole covers, to name some recent candidates for protection.

The question is frequently asked, "Other nations do not have a policy of freer trade, so why should we?" But rather than talking in absolutes, the more appropriate question to ask is, "Are the trade policies of other nations more open today than they would be without the continued pressure of agreed international 'rules of the game'—rules developed under the persistent and patient influence of the United States?"

The answer is a resounding "yes." Trade policy, here and elsewhere, is far more open today as a result of our efforts and of our example of an open domestic market. Our federal system, after all, was the original common market.

Is the U.S. better off with lower trade barriers? Again, the response is positive. The goods we import are cheaper than domestic substitutes. Our 225 million consumers have more choice. The markets for our exports are less restricted than they otherwise would be. Thus, despite the numerous real obstacles, many American companies have experienced significant success in penetrating foreign markets. Coca Cola is the largest-selling soft drink in Japan, Schick is the number one in their razor market, and Nestle commands 70 percent of Japan's instant coffee market.

The credibility of this country's commitment to open and freer trade is not enhanced by companies sending their lawyers to Washington on Monday to seek the removal of import barriers overseas; and then turning around on Wednesday to send the same attorneys back to Washington to *advocate* import restrictions on the products of their foreign competitors.

International trade policy will not remain static. The choice is between a further drift to protectionism and a joint effort to remove trade barriers.

The longer we wait to move decisively to freer world trade, the more obstacles will be in place and the more difficult it will be to remove them. The best time to move to free trade is now.

Note: This paper by Murray Weidenbaum is collected into the new Volume 10 of Hillsdale's Champions of Freedom *book series, along with other essays on economic freedom by Bruce Bartlett, Arthur Shenfield, Lewis Lehrman, and Martin Anderson.*

Another Hillsdale paper by Dr. Weidenbaum, "Reforming Government Regulation of Business," appears in the Makers and Takers of America's Wealth *volume of our* Essential Imprimis *anthology.*

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